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2 Honorable Bruce A. Markell
3 United States Bankruptcy Judge
4

Entered on Docket
November 06, 2012

5 UNITED STATES BANKRUPTCY COURT
6 DISTRICT OF NEVADA

7 * * * * *

8 In re:) Case No.: BK-S-11-24415-BAM
9 PHILLIP JOSEPH OHLER,) Chapter 7
10 Debtor.)
11 ARTESIA GROUP, LLC,) Adversary Proceeding No.: 11-01376-BAM
12 Plaintiff,)
13 vs.) October 4, 2012
14 PHILLIP JOSEPH OHLER,) (matter submitted on the briefs)
15 Defendant.)
16

17 OPINION DENYING ARTESIA GROUP, LLC'S NONDISCHARGEABILITY CLAIMS
18 UNDER 11 U.S.C. § 523(a)(2)¹

19 This adversary proceeding arises from a dispute between Artesia Group, LLC ("Artesia")
20 and Phillip Joseph Ohler about whether Ohler fraudulently obtained a loan from Artesia for his
21 fledgling business, American Wireless. When the loan, which Ohler had personally guaranteed,
22 went into default, Artesia sued Ohler in state court on various claims for relief, including breach of
23 contract and fraud. After Ohler answered the Complaint and only partially participated in

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25 ¹Unless specified otherwise, all "Chapter" and "Section" references are to the Bankruptcy
26 Code, 11 U.S.C. §§ 101–1532; and all "Rule" references are to the Federal Rules of Bankruptcy
Procedure, FED. R. BANKR. P. 1001–9037.

discovery, the state court struck his Answer as a sanction for failing to comply with discovery orders. The state court then ordered a default judgment (the "Default Judgment") in favor of Artesia for approximately \$155,000.

4 Ohler has since filed a Chapter 7 petition in this court. Artesia followed with this adversary
5 proceeding, claiming that the loan debt, in particular Ohler's personal guaranty (the " Personal
6 Guaranty"), is nondischargeable under Sections 523(a)(2)(A) and (B) because the loan was
7 obtained by fraud. Trial was set for September 14, 2012, but the parties agreed to submit the matter
8 on the briefs. The parties also agreed that the sole legal issue is whether the Default Judgment has
9 preclusive effect for the issue of fraud. Because the Default Judgment did not expressly find that
10 Ohler had committed fraud, this court holds that it is not preclusive on that issue. As Artesia did
11 not submit any evidence to support an independent finding of fraud under Sections 523(a)(2)(A) or
12 (B), the court finds for Ohler. His obligation under the Personal Guaranty is dischargeable.

I. BACKGROUND

14 || A. Factual History²

15 In January of 2007, Ohler formed American Data Centers, which later merged with another
16 company to become American Wireless Networks, Inc. (" American Wireless"). (Dkt. No. 22 at
17 3-4.) The company's business was telecommunications networking and data storage. (*Id.*) In mid-
18 2007, Ohler met with Artesia to seek investment capital. (*Id.* at 4; Dkt. No. 18 at 4.) Artesia
19 declined to invest and instead made a short-term bridge loan for \$200,000, which Ohler personally
20 guaranteed. (Dkt. No. 18 at 4-5; Dkt. No. 22 at 4.) To convince Artesia to make the loan, Ohler
21 presented projections about the financial future of American Wireless. (Dkt. No. 18 at 4; Dkt. No.
22 22 at 4.) Ohler argues that he made clear that the projections were not certain, while Artesia argues

²The following recitation is based on the parties' trial briefs and attached affidavits. (Dkt. Nos. 18, 22.) The court does not present this history as a finding of fact, but rather to provide context for the parties' assertions and the court's analysis.

1 that Ohler intentionally misrepresented American Wireless's business prospects. (Dkt. No. 18 at
2 4-5; Dkt. No. 22 at 4-5.)

3 American Wireless defaulted on the loan in September of 2007, and Artesia then extended
4 the maturity date to November 2007. (Dkt. No. 18 at 5.) American Wireless again failed to repay
5 the loan by the maturity date in November, upon which Artesia negotiated a daily payment
6 schedule. (Dkt. No. 18 at 6.). American Wireless failed to meet the payment schedule, and Artesia
7 demanded full payment in March 2008. (*Id.*) American Wireless filed a Chapter 7 petition in this
8 court in October 2008.³ Artesia later sued Ohler in Nevada state court when he failed to perform
9 under the Personal Guaranty. (*Id.*)

10 B. Procedural History

1. Nevada State Court Action

12 On March 17, 2009, Artesia filed a Complaint in the Eighth Judicial District in Clark
13 County, Nevada (the " State Court Action").⁴ (Dkt. No. 18-1, Ex. 1.) Artesia plead five claims for
14 relief: (1) breach of contract; (2) breach of implied covenant of good faith and fair dealing; (3) fraud
15 in the inducement; (4) fraud; and (5) negligent misrepresentation. (*Id.*) For all five claims, Artesia
16 sought attorneys' fees, costs, and at least \$10,000 in damages. (*Id.*) For the two fraud claims,
17 Artesia also sought punitive damages. (*Id.*) On May 18, 2009, Ohler filed his Answer, denying all
18 of Artesia's claims. (Dkt. No. 19-1, Ex. 2.) In June 2009, counsel for both Artesia and Ohler
19 appeared at the Early Case Conference, where they developed a discovery plan. (See Dkt. No. 18-1,
20 Ex. 3.)

21 Ohler's participation soon diminished and then ceased altogether. He responded to
22 Artesia's requests for admission but not to interrogatories or requests for document production.

³*In re Am. Wireless Networks* (Bankr. D. Nev. 2011) (No. 08-22980-LBR).

⁴ *Artesia Group LLC v. Phillip Ohler* (Nev. 8th Jud. Dist. 2011) (No. 09A585449).

1 On March 23, 2010, Artesia filed a Motion to Compel Discovery. (Dkt. No. 18-1, Ex. 6.) On April
2 15, 2010, Ohler's counsel followed with a Motion to Withdraw, citing an inability to maintain
3 consistent contact and communication with Ohler. (Dkt. No. 18-1, Ex. 7.) On April 23, 2010,
4 neither Ohler nor his counsel appeared at the hearing on the Motion to Compel Discovery. (*See*
5 Dkt. No. 18-1, Ex. 8.) The Discovery Commissioner recommended that the court grant the Motion
6 to Compel, noting Ohler's complete failure to respond to and answer interrogatories and document
7 requests, and extended the discovery deadline to May 7, 2010. (*Id.*) The state court adopted the
8 recommendations on June 2, 2010. (*See id.*)

9 On May 14, 2010, the state court extended the discovery deadline to June 30, 2010 and
10 deferred any sanctions until then. (Dkt. No. 18-1, Ex. 9.) On May 18, 2010, the state court granted
11 the Motion to Withdraw by Ohler's counsel. (Dkt. No. 18-1, Ex. 10.) After Ohler failed to meet
12 the June 30 deadline, the state court signed the Order to Strike Answer on September 16, 2010.
13 (*See* Dkt. No. 18-2, Ex. 14.) On March 31, 2011, the state court held a prove-up hearing on
14 damages, at which Ohler failed to appear. (*Id.*) The state court entered default on June 16, 2011 for
15 "failure to appear at the prove-up hearing . . . failing to answer or otherwise plead to Plaintiff's
16 Complaint" (Dkt. No. 18-2, Ex. 14.)

17 On June 30, 2011, Artesia filed its Application for Entry of Default Judgment. (Dkt. No. 18-
18 1, Ex. 13.) Artesia demanded \$155,346.85 for the sum of the outstanding principal balance due on
19 the loan; default interest; attorneys' fees and costs incurred to date; attorneys' fees and costs to be
20 incurred in enforcement of the default judgment; and post-judgment interest. Notably, although
21 part of the original prayer for relief, Artesia did not seek punitive damages.

22 On August 3, 2011, the state court granted default judgment. The order states:

23 IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Plaintiff's
24 Motion for Default Judgment is GRANTED as it pertains to Defendant PHILLIP J.
25 OHLER. Judgment is entered in favor of Plaintiff and against Phillip J. Ohler in the
amount of: \$155,346.85. This sum is hereby reduced to judgment. This sum

1 represents (1) \$95,000.00 for the outstanding principal balance due on the loan; (2)
 2 \$36,500.00 for default interest; (3) \$16,346.85 as and for the Plaintiff's attorneys'
 3 fees and costs incurred; (4) \$7,500.00 for attorneys [sic] fees and costs to be
 incurred in enforcement of the Judgment; and (5) for post-judgment interest, as
 provided by law.

4 (Dkt. No. 22, Ex. A (emphasis in original).) Artesia's counsel drafted the order; the language
 5 itemizing the judgment amount is identical to that in the Application for Entry of Default
 6 Judgment. (See Dkt. No. 18-1, Ex. 13.)

7 The judgment does not indicate which of the facts were essential to the state court's
 8 determination.⁵ The state court did not expressly find that Ohler had committed fraud. The nature
 9 and amount of damages were common to all of Artesia's claims; punitive damages were not
 10 requested or awarded.

11 *2. The Bankruptcy Case and Related Adversary Proceeding*

12 On September 12, 2011, Ohler filed his Chapter 7 bankruptcy petition. (Bankr. Dkt. No. 1.)
 13 Three months later, on December 13, 2011, Artesia filed the Complaint in this adversary
 14 proceeding. (Dkt. No. 1.) Artesia argues that Ohler's debt under the Personal Guaranty is
 15 nondischargeable under Sections 523(a)(2)(A) and (B) on the same factual basis as the State Court
 16 Action—that the loan was obtained by fraud. (*Id.*)

17
 18 _____
 19 ⁵The minutes to the Prove-Up Hearing, which neither party attached to their briefs, indicate
 that the court viewed the default as based on breach of contract:

20 Court stated it had reviewed the Motion for Default Judgment and as to principal owed,
 21 accrued [sic] interest, post judgment interest, and fees to collect, there are no issues and
 22 the Court would be willing to grant additional fees. Further, Court stated its only
 23 concern was with punitive damages and the Court would need explanation of how it
 24 could justify awarding punitive damages in a contract case, otherwise Court is willing
 25 to grant default.
 26 Mins., Prove Up Hr'g, Mar. 31, 2011, *Artesia Group LLC v. Phillip Ohler* (Nev. 8th Jud. Dist. 2011)
 (No. 09A585449). The minutes are not, however, an official communication by the state court and
 do not prove that the judgment solely relied on the breach of contract claim. The relevant fact is that
 the Default Judgment does not indicate which facts were necessary to the Judgment.

1 Section 523(a)(2)(A) provides that a Chapter 7 discharge " does not discharge an individual
 2 debtor from any debt . . . to the extent obtained by false pretenses, a false representation, or actual
 3 fraud, other than a statement respecting the debtor's or an insider's financial condition[.]" Section
 4 523(a)(2)(B) covers the statements excluded under Section 523(a)(2)(A); a debt obtained by a
 5 materially false written statement respecting the debtor's or an insider's financial condition on
 6 which the creditor reasonably relied and the debtor intended to publish with intent to deceive is
 7 nondischargeable. Artesia argues that Ohler's conduct fits both subsections. (*Id.*)

8 On January 20, 2012, Ohler filed his Answer. (Dkt. No. 7.) He denied the allegations of
 9 fraud and alleged various procedural infirmities on Artesia's part. (*Id.*) Trial was set for September
 10 and the parties filed trial statements; the parties agreed that the only legal issue is whether the state
 11 court judgment should be given preclusive effect on the issue of fraud. (Dkt. Nos. 13, 14. *See* Dkt.
 12 No. 11.) The parties then stipulated to submit the matter on briefs and declarations.⁶ (Dkt. No. 15.)

13 **II. DISCUSSION**

14 A. Issue Preclusion⁷

15 Issue preclusion is a doctrine that prevents the relitigation of issues that were decided in a
 16 prior proceeding, even if the later proceeding is based on different claims. *Howard v. Sandoval (In*
 17 *re Sandoval)*, 232 P.3d 422, 423 (Nev. 2010). The principles of issue preclusion apply to
 18 nondischargeability proceedings brought under Section 523(a). *Grogan v. Garner*, 498 U.S. 279,
 19 284 n.11 (1991). Under 28 U.S.C. § 1738, the Full Faith and Credit Act, federal courts must apply

21 ⁶The " Order to Vacate Trial and Submit Matter on Briefs and Declarations," states that the
 22 trial was vacated. (Dkt. No. 16 at 2, ¶ 1.) That is not correct. Although the parties stipulated to
 23 "vacate" the trial, their intention was to try the matter on the briefs and declarations, not to cancel the
 24 trial altogether. The court hereby vacates the portion of that order that purported to vacate the trial.
 (*Id.*)

25 ⁷Issue preclusion is the modern term for collateral estoppel.

1 the preclusion law of the state whose court issued the prior judgment. *Harmon v. Kobrin (In re*
 2 *Harmon)*, 250 F.3d 1240, 1245 (9th Cir. 2001) (citations omitted). Under Nevada law, issue
 3 preclusion has four elements:

4 (1) the issue decided in the prior litigation must be identical to the issue presented in
 5 the current action; (2) the initial ruling must have been on the merits and have
 6 become final; . . . (3) the party against whom the judgment is asserted must have
 been a party or in privity with a party to the prior litigation; and (4) the issue was
 actually and necessarily litigated.

7 *In re Sandoval*, 232 P.3d 422 at 423. Artesia and Ohler dispute only the first and fourth elements.

8 1. *Identity of Issues*

9 The Ninth Circuit has held that "a finding of debt due to fraud is all that is required to
 10 satisfy § 523(a)(2)(A)." *Muegler v. Bening*, 413 F.3d 980, 983 (9th Cir. 2005) (citing *Cohen v. de la*
 11 *Cruz*, 523 U.S. 213, 223 (1998)). "It is only the fact of an adverse fraud judgment, and nothing
 12 more, that is required for a debt to be nondischargeable." *Id.* at 984 (citation omitted). There need
 13 not be a perfect identity of elements. *See id.* Thus, Ohler's argument that the issues are not
 14 identical because Section 523(a)(2)(A) specifically excludes "statement[s] respecting the debtor's
 15 or an insider's financial condition" and Section 523(a)(2)(B) requires such statements as an
 16 essential element, fails. Moreover, the elements of actual fraud under Nevada law and Section
 17 523(a)(2)(A) are nearly identical. *See Barmettler v. Reno Air, Inc.*, 114 Nev. 441, 446–47, 956 P.2d
 18 1382, 1386 (1998); *Apte v. Japra (In re Apte)*, 96 F.3d 1319, 1322 (9th Cir. 1996). Excepting the
 19 written statement requirement, and *reasonable* reliance instead of *justifiable* reliance, the required
 20 elements under Section 523(a)(2)(B) are also nearly identical. *See* 11 U.S.C. § 523(a)(2)(B) (2011).
 21 There is sufficient identity of issues to meet this element of issue preclusion.

22 2. *Actually Litigated*

23 The Nevada Supreme Court held, upon a question certified to it by this court, that "when a
 24 default judgment is entered based on failure to answer, issue preclusion is not available because the
 25
 26

1 issues raised in the initial action were never actually litigated." *In re Sandoval*, 232 P.3d at 424.
 2 Even if a defendant is properly served and/or actually aware of the allegations and simply chooses
 3 not to litigate, issue preclusion does not apply. *See id.* The Court did not reach the issue of
 4 whether preclusion is available when a default judgment is based on abusive or dilatory litigation
 5 tactics. *See id.* n. 1.

6 The Ninth Circuit, on the other hand, has reached this precise issue and held that issue
 7 preclusion applies in such a circumstance. *Fed. Deposit Ins. Co. v. Daily (In re Daily)*, 47 F.3d 365,
 8 368–69 (9th Cir. 1995). "The 'actual litigation' requirement may be satisfied by *substantial*
 9 *participation* in an adversary contest in which the party is afforded a reasonable opportunity to
 10 defend himself on the merits but chooses not to do so." *Id.* at 368 (emphasis added). This court
 11 predicts that the Nevada Supreme Court would follow the rule set forth in *In re Daily*. Under *In re*
 12 *Daily*, the court finds that Ohler substantially participated in the State Court Action by filing an
 13 Answer and participating in discovery; he did not simply give up from the outset. *See id.*
 14 Therefore, the issue of fraud was actually litigated in the State Court Action. *See id.*

15 *3. Necessarily Decided*

16 The Ninth Circuit has addressed whether an issue has been "necessarily decided" and
 17 found that the record must "show an express finding upon the allegation for which preclusion is
 18 sought." *In re Harmon*, 250 F.3d at 1247 (citation and internal quotation marks omitted). Even
 19 though a defendant admits all the facts that are well-pleaded in the complaint as true by failing to
 20 answer, or where the answer is stricken, those factual admissions only have preclusive effect in a
 21 later action to the extent that they were necessary to support the prior court's judgment. *See id.* It
 22 is critical that they be necessary; although a group of facts found might be sufficient, if it cannot be
 23 shown that they were necessary and essential to the judgment entered, this element of issue
 24 preclusion is not met.

1 Whether Ohler committed fraud was not necessarily decided in the State Court Action
2 because the Default Judgment does not state upon which claims for relief it is grounded.
3 Moreover, the Default Judgment could be supported by facts in the Complaint that were
4 completely unconnected to the fraud claim. Put another way, the Judgment could be sustained on
5 only the allegations related to the breach of contract claim without ever reaching the allegation
6 touching on fraud. If the Default Judgment had included punitive damages, or some other way to
7 link the damages to an express finding of fraud, then issue preclusion might apply. *See Cal-Micro,*
8 *Inc. et al. v. Cantrell (In re Cantrell)*, 329 F.3d 1119, 1125 (9th Cir. 2003).

9 As a consequence, Artesia's claim of issue preclusion fails because, although the issue of
10 fraud was actually litigated, the state court did not expressly find that Ohler's debt was obtained by
11 fraud. The only aspect of the Default Judgment that has preclusive effect is thus the dollar amount
12 because the judgment expressly states that amount: \$155,346.85. Ohler's debt in this amount
13 under the Personal Guaranty, however, is dischargeable because the state court did not necessarily
14 decide the issue of fraud.

15 B. Sections 523(a)(2)(A) and (B)

16 There are insufficient facts to support an independent finding of fraud under Sections
17 523(a)(2)(A) or (B). The only facts admitted for this trial, because they are the only ones that are
18 necessary for the judgment, are the claim amount.⁸ Artesia argues in its trial brief that Ohler's
19 behavior constitutes fraud. But those factual assertions are merely argument, not facts admitted
20 into evidence. The facts that Ohler admitted as true by operation of the stricken Answer do not
21 "carry over" as evidence in this court because, whether true or not, they were not necessary to the
22 Default Judgment. They thus have no preclusive effect.

23
24 ⁸By agreeing to try the matter on the briefs, Artesia waived the right to present any evidence
25 other than the Default Judgment.

1 III. CONCLUSION

2 Because the issue of fraud was not necessarily decided in the State Court Action, it does not
3 have preclusive effect on this court. Nor did Artesia independently establish a finding of fraud
4 under Sections 523(a)(2)(A) or (B). Consequently, Artesia's nondischargeability claim fails. The
5 Default Judgment is preclusive for the claim amount, \$155,346.85, but the debt that forms the basis
6 of Artesia's claim—the Personal Guaranty—is dischargeable.

7 This opinion constitutes the court's findings of facts and conclusions of law under Rule
8 7052. Judgment for the Defendant, Phillip Joseph Ohler, is entered under Rule 7058 in a separate
9 document.

10 Copies sent to:

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